Starting Down the Road To Retirement

Saving and Investing Can Be Painless

Gordon Tiffany

No one has a precise formula for creating the financially perfect retirement. But establishing a habit of regular saving and investing is a necessary step. Are Americans on the whole heeding this advice? So far, it would appear not. While most American workers have ready access to at least one kind of retirement savings program through their jobs, statistics show that they are not taking full advantage of these plans and may be in for a shock when it is time to retire. Can we do anything about it? Here are a few techniques for making saving and investing as regular and as painless as possible.

Comparatively speaking, Americans are not saving as well as their international counterparts: we have the lowest savings rate of any of the industrialized countries, a paltry 4.7 percent, compared with 15 percent in Canada and Japan. But even more important than the amount we are or are not saving is the investment vehicles we are choosing.

Recent statistics reveal that close to 60 percent of 401(k) money in the United States is invested in guaranteed investment contracts (GICs), which are low-earning, stable-value instruments vulnerable to rising inflation. And although stocks and stock funds historically provide better long-term returns than do other kinds of investments, 75 percent of people participating in defined contribution plans do not invest in stock funds.

Taken together, these factors point to an alarming potential shortfall of funds for future retirees, as confirmed by a recent Merrill Lynch survey, which reported that

baby boomers are saving only 38 percent of what they need to save to retire. This shortfall is becoming even more serious as both the private and public sectors move from traditional, defined benefits to various forms of self-directed retirement plans. Workers will be called upon increasingly to make important financial and investment decisions for themselves. (See Part 1 of this series of articles on retirement planning, in the October 1995 issue of *Public Management*, for a more complete discussion of these topics.)

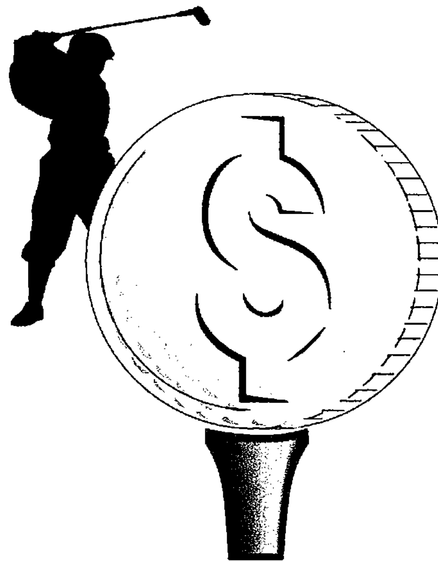
Your Personal Best

Against this dismal backdrop of poor planning, can people do better? The answer is a cautiously optimistic "yes." If we trim our financial sails by curtailing our spending and engineering a mid-course correction by starting a serious savings program, it is possible to make a vast improvement in our financial prospects for the future. For people who want to be able to choose their retirement lifestyles instead of letting their finances choose for them, experts in retirement planning offer the following rules of thumb:

1. Take full advantage of all pre-tax and tax-deferred retirement savings opportunities. After maximizing your investment dollars through these vehicles, including your spouse's plan, look next to after-tax savings opportunities, such as nondeductible IRA contributions.

2. Start early. The "magic of compounding" works best when you start saving early and your money has time to grow. Year after year, money that is invested earns interest and dividends (and is not taxed, while it is in a retirement savings plan). Those earnings in turn generate additional earnings, and so on. This snowball effect can create quite a nest egg if contributions are started early and kept up regularly.

To illustrate, consider the value of $1 invested by an employee at age 25 in a stock fund returning 10 percent. Forty years later, when the investor has reached age 65, that dollar has grown to $45. The same dollar invested at age 45, however, will only return $7 by age 65. So the sooner a person starts saving for retirement, even if the amounts are modest, the greater the benefits he or she will receive from the power of compounding.



The two most important things that can be done to assure a good retirement are to begin saving early and to increase the amount regularly. (The Retirement Corporation's publication *Charting Your Course* provides a complete discussion of how much to save, including worksheets.)

3. Invest automatically. Instead of writing a check each month, have your retirement contributions automatically deducted from your paycheck or from your checking account. The idea here is that you cannot spend what you don't have, and if you don't really "have" it, you won't miss it. And if you can invest a regular amount each month, you will be doing something called "dollar-cost averaging," that is, you will be buying more of a security when its price is low and less of it when the price is high. This is especially important when investing for the long term in volatile stocks or stock funds.

4. Split a raise. Make a deal with yourself to split your next pay increase. Promise yourself that the next time you get a raise, half of it will go into the retirement account and half of it will be taken home to spend. It is surprising how easy this can be.

5. Don't just save, invest. Investing for the long run allows for more aggressiveness in investment decisions. Remember, there is a long time for the investments to work, especially if the savings habit was started early. Taking appropriate investment risk means that in the long term, investments probably will grow more, even though in the short term, their value will fluctuate.

6. Protect the tax-deferred status of assets in qualified plans and IRAs. If you change employers and have a qualified plan, you should make sure that the assets within the plan do not lose their tax-deferred status. That way, you will not have to pay withholding taxes or penalties, and the money can continue to compound, tax-deferred. The same is true for a 457 deferred compensation plan, if a worker moves to another public sector employer that also maintains a 457 deferred compensation plan. The employee may decide to "roll over" these assets, depending on tax, inflation, and investment-quality issues.

7. Don't plan on using retirement funds for nonretirement expenses. If you are trying to put aside funds for your children's education or other financial goals, don't mix these funds with your retirement money! Doing

so will sacrifice the unique tax advantages available only to retirement savings and may subject the monies to an additional penalty tax.

8. Learn as much as possible about investing. Learning the basic principles of investing is not at all difficult—all it takes is a little time and a little discipline. Many financial periodicals, books, and now software packages and videos can help you learn about investing and also help keep track of your assets. Some individuals have found that joining an investment club is an enjoyable way to learn about investing while meeting new social contacts.

RC's own retirement planning series provides a step-by-step way to learn the basics of planning and investing. *Charting Your Course, Investing for the Harvest Years,* and *Portfolios for Your Future* all were designed to provide the tools necessary to begin the journey down the road to a successful retirement.

To many, the questions posed by retirement issues seem overwhelming, so they are put off until another day. And another. And another. Until it is almost too late to do any real saving and investing for the future. The worst thing that can be done is nothing at all. Getting started, no matter how small the effort, is critical.

Investing is not complicated if you are in for the long run, can invest in a portfolio of well-diversified funds, and stay away from "market timing"—attempts to outguess financial markets and to move into and out of assets accordingly.

So go ahead. Do a little homework. Do it now, and you will be able to put the "gold" back into your "golden years." You will thank yourself for it many times in the years to come. PM

Gordon Tiffany is a certified financial planner and director of financial and retirement planning at the ICMA Retirement Corporation. This is the second of a four-part series on retirement planning. Future articles will involve information on fighting inflation and on investment basics. For more information, or to obtain copies of RC's retirement planning publications, call 1-800/669-7400.